RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

Since 1958

Post Office Box 1759, La Jolla, California 92038 17 Letters Per Year • $250 annually www.dowtheoryletters.com

April 12, 2000 **LETTER 1299**

THE PICTURE: There's no question about it, the dominant force in the market during 1999 and early 2000 was the historic parabolic rise in the Nasdaq. When something occurs to interrupt the dominant market force, Wall Street stops and takes notice.

The interruption has now occurred. The only question is, "Has the Nasdaq topped out for the duration, in other words, is it in a bear market -- or has the market and more specifically the Nasdaq simply lapsed into a correction?" Frankly, at this point it's only a guessing game.

It's well to remember that a true bear market not only entails the extent of the decline, it entails **duration.** For instance, if the 1987 crash had extended to a ten-month decline instead of a few days, it would have gone down in history as a bear market, not a correction.

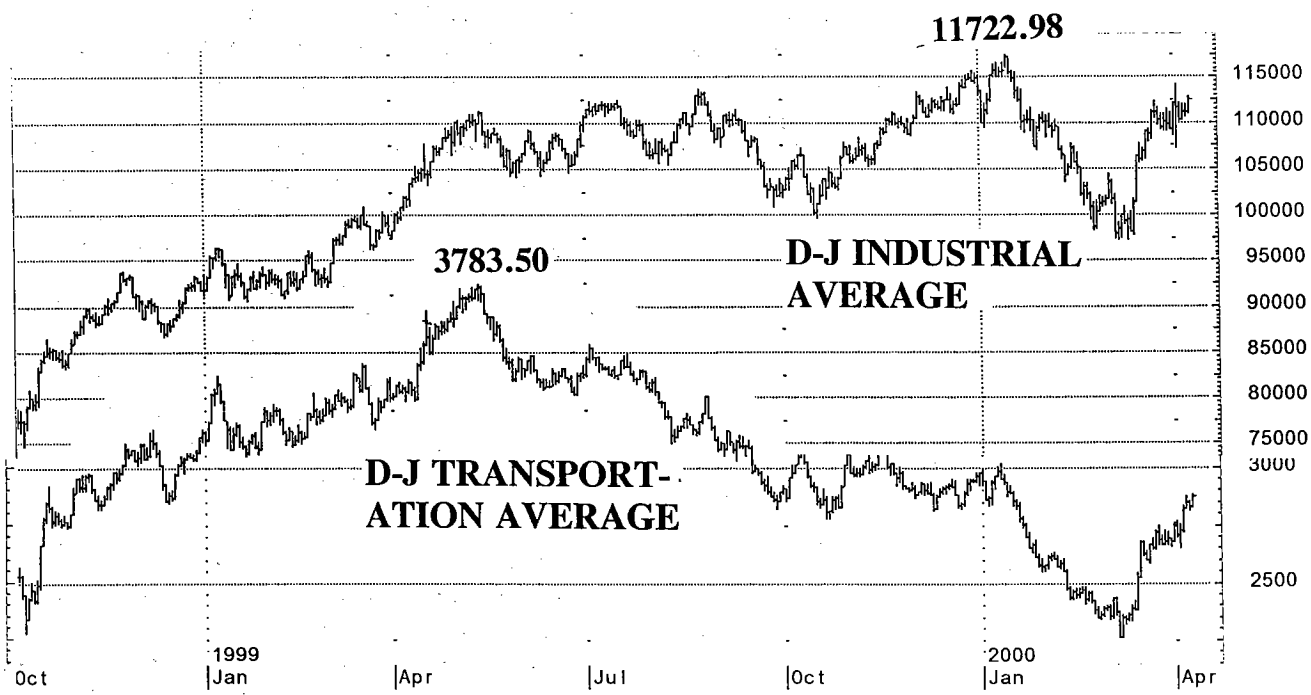
The Nasdaq recorded its high only last month on March 10 at 5048.62. The intra-day smash of April 4, although huge, did not last long enough to qualify as a primary bear market. The 200-day moving average of the Nasdaq comes in now at roughly 3455. So the Nasdaq has not even **closed** below its 200-day MA (actually, at the worst of its April 4 smash, the lowest the Nasdaq got was 3649).

Mar. 24 DJIA 11112.15; PTI 5155; A-D Ratio -7.05
Mar. 31 DJIA 10921.92; PTI 5142; A-D Ratio -6.84
Apr. 7, DJIA 11111.48; PTI 5150;A-D Ratio -6.80
Dow Yield: 1.40%; Dow Price/Earnings: 23.9
Dow Times Book Value: 7.2% ; PTI 89-day exp. MA: 5174
Percentage of Undervalued Blue-chips: 27%
Gold 34-day MA: 289

The Nasdaq study in this Letter suggests that the Nasdaq could have a good deal further to go on the downside. The Nasdaq led by the tech stocks has embarked on one of the wildest, most speculative advances in stock market history. Furthermore, many of the stocks that are heavily weighted in the Nasdaq are selling at sky-high, really absurd multiples, multiples not necessarily of earnings but of sales.

The advance-decline ratio recorded what seemed to be an important low on March 14, a low of minus 8.14. But the rise off the March 14 low has been feeble at best. The farthest the A-D ratio got on the rally from the March 14 low was -6.80, a rise of only 1.34 points.

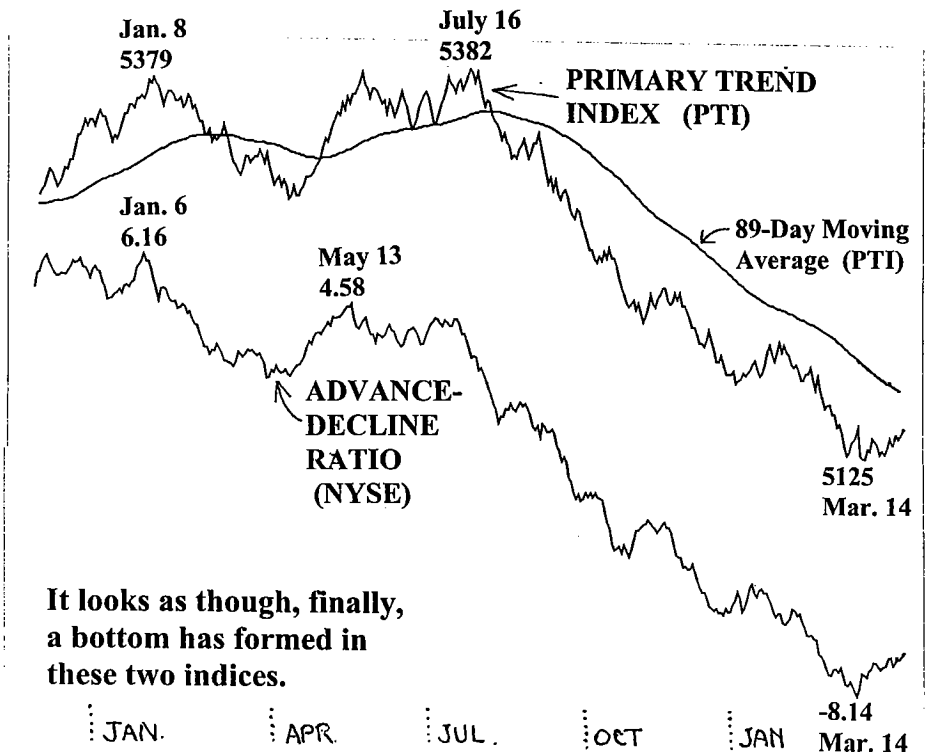
In the face of the impressive advance in the Dow and the S&P this is one of the poorest recoveries in the A D Ratio that I've ever seen.



This goes with another statistic, and it is that only 33% of all the stocks on the NYSE are above their 200-day moving averages. Thus, the majority of stocks on the Big Board remain in bear markets of their own.

BIG PICTURE: With all the wild swings of the stock market, with the huge volatility, it's easy to lose sight of the big picture. The big picture, of course, is the direction of the primary trend of the market.

On this count, I'll stick with my Primary Trend Index (PTI), which peers beyond the trees and looks at the forest. The PTI turned bearish on July 29, 1999, when it broke below its moving average (the PTI was then 5353). The PTI has been in its bearish mode ever since.



During the period since July 29 the bear market which the PTI signaled has been masked by the wild and explosive action of the Nasdaq and more particularly the Nasdaq 100. Despite the rise in the Nasdaq, the PTI has remained firmly in the bear camp.

One of the advantages (to me) of the PTI is that I don't have to interpret anything. The movements of the PTI are automatic, and the PTI couldn't care less for my opinion.

Right now the PTI is at 5152 and the moving average is 5174. There is only a 22 point spread between them. If the PTI can move up and advance above its moving average, the primary trend will be adjudged as bullish, at least as far as the PTI is concerned. Let's see if that can happen. If it does, then the PTI will have turned bullish for the first time since last July.

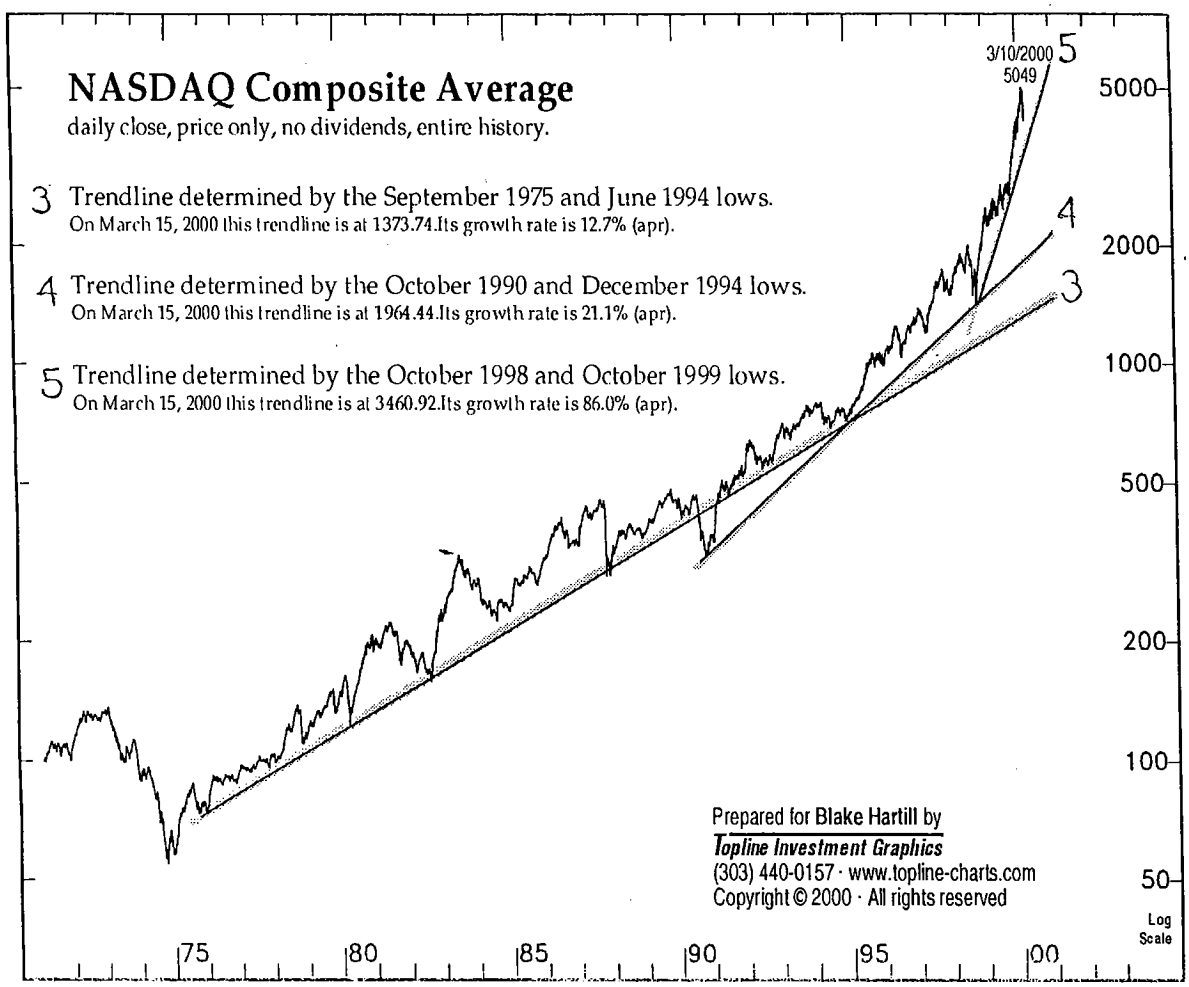
NOTE: Because these markets move so fast and are so erratic, I'm going to hold my discussion of the current market to Late Notes at the end of this Letter.

I do want to comment on one item. John Crudele, who writes an outstanding financial column for the *NY Post* newspaper, wrote a piece on March 5 which touched on a subject that I've received dozens of letters about. Crudele states that Washington has a "secretive group" called the "Working Group on Financial Markets," made up of investment industry and government people. He states that "Wall Streeters call this group the 'Plunge Protection Team.' In February 1997 the Washington Post did a piece on this team, just in case you don't believe it exists."

At any rate, Crudele notes that near the bottom of the April 4 crash (Dow down 500 points) "someone started buying large amounts of stock index futures contracts through two major brokerage firms -- Goldman Sachs and Merrill Lynch. These transactions are usually done on the QT, so we don't know how many of these contracts were purchased. And unless the brokers tell, there is no way of knowing which of their clients were making the purchases. Goldman wouldn't comment on this and Merrill did not return a call for comment. But traders said enough were bought to catch everyone's attention. In fact, the buyers seemed to want people to know they had an appetite for stocks --- then the market rebounded."

Russell Comment: For many years I've heard rumors that at critical times the government (in disguised form) comes in and manipulates the market. Do I believe it? I've always been skeptical, but now I am beginning to believe it. Can the government or its agents turn the tide, stop a bear market from expressing itself? Maybe for a few days or even a few weeks (we know the government openly 'intervenes' in currency moves), but ultimately, over the long term the primary trend will always prevail. I've often written that "The primary trend is more powerful than the President, the Treasury and the Congress all taken together."

NASDAQ: My old friend, John Carder, has built a library of market statistics and data second to none. And if there's a chartist who is more astute about trends and what's happening to the markets at any given time, I've never met him (John's firm is Topline Graphics, 303 440 0157).


NASDAQ Composite Average
daily close, price only, no dividends, entire history.
3 Trendline determined by the September 1975 and June 1994 lows.
On March 15, 2000 this trendline is at 1373.74.Its growth rate is 12.7% (apr).
4 Trendline determined by the October 1990 and December 1994 lows.
On March 15, 2000 this trendline is at 1964.44.Its growth rate is 21.1% (apr).
5 Trendline determined by the October 1998 and October 1999 lows.
On March 15, 2000 this trendline is at 3460.92.Its growth rate is 86.0% (apr).
3/10/2000
5049
5000
2000
1000
500
200
100
50
Log Scale
75
80
85
90
95
00
Prepared for Blake Hartill by
Topline Investment Graphics
(303) 440-0157 · www.topline-charts.com
Copyright © 2000 · All rights reserved

Recently John sent me a set of charts (prepared for Blake Hartill) that are extremely important in its implications. I discussed the ominous implications of this study on one of my recent Internet reports. But I want to present the study in more details now.

I include one of Carder's charts on page 3. Here we see the Nasdaq going back to the early 1970s. The most recent and steepest trendline on this ratio chart is labeled #5. Writes John, "Nasdaq: Example of a mania. The growth of the Nasdaq has become extreme. Trendline #5 is growing at 86% a year. There is no historical precedent for any stock market index sustaining a growth rate of 86% per year for a prolonged period of time.

"From January 28 to March 10 the Nasdaq rose 29.9%. For comparison, in the six weeks before the 1929 peak, the DJIA only grew 10.9%. In the twenty-one weeks before March 10, 2000, the Nasdaq rose 87.8%. In the entire history of the DJIA going back to 1885, the only time the twenty-one week percent change was that high was in 1933, rebounding off the extreme 1932 lows."

Russell Comment: So far, and despite the "big spill" of April 4, the Nasdaq has not even violated its steepest and least sustainable trendline, trendline #5. This is the trendline that is growing at the rate of 86% a year.

If trendline #4 is touched, the move will go down as a bear market in the Nasdaq. If trendline #3 is touched, the move will go down in history as a total disaster. Yet trendline #3 (which is now well below 2000 on the Nasdaq) has been growing ever since 1975 at the rapid rate of around 12.7%.

So the whole point of this study is to suggest that the current rate of ascent by the Nasdaq is in all likelihood unsustainable. And the question is whether or when the Nasdaq will come down to test trendlines #4 and #3.

INVESTMENT POSITION The bear stays in the box, and we continue to deal with the sneakiest and maybe the most manipulated market in Wall Street history.

From what I've seen, I'd say that it's a good deal easier to lose money in this market than to make it. Remember, if you take a 50% loss in your portfolio, you have to make

100% after taxes to bring it back. And that, in case you didn't realize it, is hard to do.

In my experience, this is a market in which you should invest in the least volatile areas of the markets. Bonds have done well, although they have already enjoyed a huge bull move. Personally, I like munis (in your home state) at this time. Many high-grade munis now yield as much or more than T-notes or T-bonds. I also like certain utilities such as SO, AWK, KSE, AEP, TXU.

For those who can't resist speculating, I suggest Spyders (SPY) on the Amex, the stock that is a proxy for the S&P. From what I see, if the S&Ps don't move up, nothing will. The S&P acts better than the Dow or the Nasdaq.

NOTES & QUOTES: Steve Gailbraith, an analyst at Sanford Bernstein, estimates that there are no less than 2.4 billion shares of stock from 1999 IPOs that will be eligible for sale in the second quarter of this year. That's a lot.

* *

Americans are getting richer, according to the latest statistics compiled by Professor Edward Wolff of NYU. For instance, in 1983, 2.4 million households were worth $1 million or more. Today five million household are worth $1 million or more. In 1983 46,500 households were worth $10 million or more, but today 350,000 households are worth $10 million or more. How about billionaires? According to **Forbes,** in 1982 there were 13 American billionaires, but today there are 267 billionaires.

* *

Prices for apartments in New York (known pre-Giuliani as Fun City) are levitating into the stratosphere. Jerry Seinfeld just paid over $20 million for a large apartment on New York's West Side. Steve Wynn of Las Vegas fame was turned down (can you believe it) when he bid $17.5 million to purchase a socialite's fifth floor co-op apartment. Computer king, Michael Dell, paid $22 million ($4 million over the asking price) for a duplex apartment in the City. In the meantime, luxury NY department store Henri Bendel boasted that Monica Lewinsky was selling pocketbooks in the store and at the same time Shoshana Lonstein (Jerry Seinfeld's ex-girlfriend) was selling her own designs in bathing suits in the store. Talk about excitement. The good times aren't just rolling in the City, they're exploding.

* *

Today there's a national frenzy to make money, a frenzy probably unmatched since the 1920s. The unabashed urge to "be rich," to be a millionaire, has swept the nation. College kids don't want to be doctors any more, they want to be venture capitalists or investment bankers.

The same thing applies to corporations. It's not enough to have a division that's doing all right, now that division has to grow at dramatic rates. I noted a few weeks ago that 3Com is going to "sell or shut weaker units." Mind you, not unprofitable or losing units, just "weaker" units. Said 3Com's president, "We will start from a smaller base, but that base represents highest growth." There's a mania to keep one's stocks pushing ever-higher. And if a stock isn't "performing," why get rid of the CEO and get one who can "give stockholders something to be happy about."

* *

Business Week's (April 3) cover story is "The Hype Machine. Wall Street is bombarding the public with an unprecedented marketing blitz." The result: Investing is becoming a high-risk sport. The article notes that "the bull market has caused a revolution in the role of the analyst, who is fast becoming less of a researcher than a celebrity pitchman – for both his employer and the stock he or she follows. In this world, nearly every stock is a buy. . . Studies show that buy recommendations outnumber sells by a staggering 72 to 1. What's more, analysts are increasingly lobbing 'absurdly extreme' calls that attract big-media attention and encourage momentum investing." From Jan. '99 to Mar. 2000 Abby Cohen (Goldman Sachs) appeared or was mentioned on TV 259 times, Joseph Battipaglia (Gruntel) 238 times, Henry Blodget (Merrill) 211 times, Ralph Acampora (Prudential) 200 times, Alfred Goldman (AG Edwards) 180 times. "The impact of a positive mention on CNBC has spawned a catch-phrase in stock trading circles -- the Squawk Bounce. . . Wall Street's advertising zoomed 95% last year to $1.2 billion, three times what it was five years ago."

* *

Who, besides the US, is hot in high-tech? It's little Israel. Israel has an estimated 1,500 high-tech start-ups and more than 100 companies listed on the Nasdaq. Israel is second only to the US in high-tech growth. Israeli problem, it's ridiculous high capital gains tax, which is driving companies out of Israel.

* *

One place that is generating big bucks on the Internet is porn. Writes *US News,* " With the exception of the *WSJ's* interactive edition and a few other ventures, porn sites are still the only ones able to generate sizable revenue via subscriptions. Most of the millions of individuals who regularly visit adult sites settle for free 'teasers'-- but enough surfers pay access fees to make porn the king of online content. Adult material accounts for 69% of the $1.4 billion pay-to-view online content market, far outpacing video games (4%) and sports (less than 2%). . . Success breeds imitation, and the market has been diluted by a slew of minor players – there are now at least 40,000 sex-oriented sites on the Web and probably more. No one has been able to count them all. . . The increased competition is buffeting the industry. Mid-level E-porn businesses are struggling and smaller sites are being forced to lower their subscription fees to $10 or less."

* *

The US's negative trade deficit it heading into the stratosphere. In January the trade deficit hit a record $28

billion. The January imbalance was 13.8% higher than December's $24.6 billion. Last year's trade deficit was $267 billion but the deficit is now running at a rate above $300 billion or better than $5 billion a WEEK! How long will foreigners continue to send us their merchandise while accepting US paper in return? That's a good question.

* *

Corporate insiders are now selling stock in their own companies at a furious rate. *Trim Tabs,* which keeps track of money flows, says that insider selling is reaching the phenomenal rate of $80 billion a month. A *WSJ* article (March 22) quotes the director of First Call as follows: "Money is leaking out of the equity markets at a faster pace than I have ever seen."

* *

One of the most pressing problems in Japan is their declining birth rate. In fact, the problem is so bad that the government is turning to dating services. Japan's Saga is the first outfit that has turned to dating services in an attempt to get people together and above all, to produce children. Said a Saga official, "Fewer people are getting married, and those that do, marry later in life. As a result, the birth rate keeps falling every year. It's a national problem." Japan has the fastest aging population of any industrialized company. Figures released last seek show that children under 14 account for only 15% of the population as against 35% in 1949.The United Nations told Japan that it would need 609,000 immigrants a year for the next 50 years to maintain its working population.

* *

The Oscars are over, but on the basis that the movies reflect mores of the times, the following was seen. This year no less than 12 movies dealt with fractured or dysfunctional families, and the winner, "American Beauty," dealt with both. Of this year's nominees, only one movie dealt with a bona fide love story. "The End of the Affair." Fourteen Academy Award movies dealt with lying or duplicity, suggesting that when in doubt, just lie. No heroes -- almost no movie dealt with real heroes, unless you want to elect Tarzan as the single hero. The slammer is the place to be -- penitentiary movies were there -- "The Green Mile," "The Hurricane," "Life," and the documentary, "The Angola Prison Rodeo."

* *

The excitement regarding B2C or business-to-consumers companies on the Internet is dying. The Internet is flooded with thousands of sites offering every conceivable kind of item. The thinking is that a few large firms will ultimately dominate the consumer end of the Internet and it's only a matter of time until companies like Wal-Mart become as big on the net as they are in their regular retail business.

* *

The following is from the Sam Zell interview by Terry Savage that appeared in the *Sun Times*. "The argument is, 'We don't have to make money (speaking of the net stocks). We just have to get there first and occupy the space. Then they'll buy us out.' But not one dot-com acquisition has been done for cash. So it's the old game: I'll trade my $10,000 dog for your two $5,000 cats... And then you've made a fortune. . . The only change I'm aware of is that people are starting to value things based on revenue instead of earnings. Now we have the American version of the Japanese kiretsu (interrelated companies doing business with each other). Venture capitalists invest in the companies, and then one company runs revenues through another, and vice versa, pumping up the numbers. Since these companies are valued on their revenues, it's like a giant Ponzi scheme. . . Yes technology cuts costs, but the vast majority of our economy is still the old economy -- and it needs to borrow money to grow. When you increase the cost of capital, you slow growth. And when you slow growth, the need for the magic wand (technology) decreases accordingly. My guess is that to support the current valuations, the old economy has to grow 20% a year. The old economy is still the customer."

* *

This from Paul Kasriel, chief domestic economist for the Northern Trust: "There are number of definitions of money." What is most helpful in gauging the economy? Kasriel votes for MZM. "The winner was MZM -- money with zero maturity. MZM consists of currency, traveler's checks, checkable deposits, saving deposits and money market mutual fund shares -- both retail and institutional. What all of these components of MZM have in common is that they are assumed by the holder to be immediately redeemable at par."

* *

An article in the March 29 *NY Times* states that the "New Economy's currency is stocks, stocks, stocks." In all sorts of business including law firms and accountancy firms, shares of stock is what is coveted, often in lieu of, or as a part payment of bills. Almost all of the stock payments are in business-to-business companies. If any subscriber wants to pay for a Dow Theory subscription with stock, that's OK with me, but please, make it an AA-rated utility with a dividend yield of 6% or better.

* *

Trouble in paradise. Brunei is the fabulous kingdom floating in oceans of oil, the nation where its citizens get everything free from education to medical to housing. Problems: it turns out that the Sultan of Brunei's brother was spending $747,000 a DAY over a period of ten years. The money was spent on yachts, airplanes, cars and jewelry according to a judge who is presiding over the case. The government accuses the prince of misappropriating a staggering $15 billion while he was finance minister and the judge has asked for an accounting for an additional $10 billion. The trial has pitted the sultan, one of the world's richest men, against his younger playboy brother. In the meantime, the populace of Brunei have been told that their fabulous good times and free perks are probably coming to an end.

* *

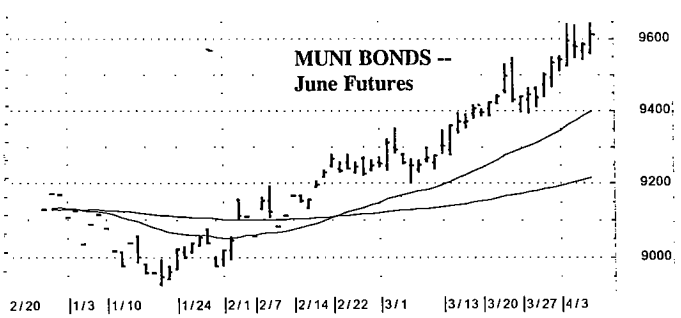
The opinion of the wise men is that the smartest thing MSFT could do, is just what it did -- not settle with the

government. In other words, time is on MSFT's side. Why? More and more it looks like power is leaving MSFT in favor of the Internet. Moreover, with Linux increasingly being used and with new non-PC items appearing almost daily, the concept of MSFT being the all-powerful beast is fading. By the end of the year we'll have a new president, and if it's Bush he's already stated that it would be shame to break MSFT up. Also, "time heals all wounds." MSFT in not settling, is stalling for time -- a very shrewd move.

BONDS: As I write this on Friday, March 7, the June bond contract is at a new high of 99 11/32. On January 18, this contract was 88 28/32. Thus, the long bond is up better than 11% for the year, so far. Add a rate of 6% interest (1.5% for the quarter) and you're talking about a total return of around 12.5% for the bonds so far this year. But with Greenspan threatening to continue raising rates, what's going on -- why are the bonds this strong in the face of Fed threats?

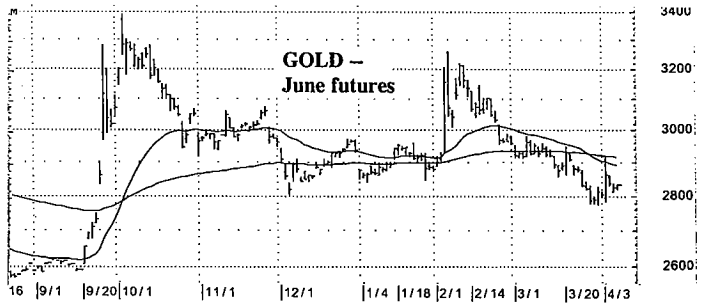
My guesses: I think Greenspan is feeling the full pressure of the White House and Congress to "cool it" on the rate boosts. Congressmen are accusing the Green man of trying to wreck the economy (as does Forbes in the week's editorial in *Forbes* magazine). How will Greenie stand up under pressure? My guess, not that well. He's a political animal, and he's constantly pictured sitting with important Washington personages.

Of course, the other thesis is that Greenspan, true to his threats, will continue to inch rates higher, push them higher until the market stall out or falls apart -- at which point the new highs in bonds will have been justified. A third thesis is that the market is now so over-priced and over-hyped that it will fall of its own weight. Any of these explanations may serve to explain why the bonds are at new highs.



None of the above has been lost on the muni bonds, and the June muni contract is shown here. Better-grade munis (tax free, state and federal) appear to be bargains, yielding as much or more than T-bonds.

GOLD: Gold continues bearish, with the 34-day MA now breaking below its 144-day MA. There's no question but that gold is sold-out and unloved. But an item can remain sold out and unloved for a long period of time, and that's about where gold has been. Each surge in gold is met with heavy selling. Manipulation? Government or central bank interference? Maybe. But the important question is not why -- it's what. And what gold is doing is acting poorly. When that changes, you'll read it here.



LATE NOTES: I was listening to a young fund manager the other day. He said "What I do is pick the 30 fastest growing stocks, and I stay with them until they stop growing." Great plan, but there's a problem -- how do you know when the market has fully discounted the best of the growth? For example, we know that Cisco is one of the fastest growing stocks in the nation. Cisco hit a high of 81 ¾ on March 27. At 81 ¾ did the market discount the best of the growth ahead?

Consider this: Cisco earned about 85 cents over the last 12 months. If earnings increase at the expected 30% annual rate over the next five years, per share earnings would be about $3.16. This means that investors who buy Cisco now are paying over 40 times what they expect Cisco to earn five years from now. That's paying a lot for a stock, no matter how good it looks today. And a lot can change in a company's fortunes in five years (look at Xerox or even MSFT).

Of course, the ideal time to buy Cisco was back in 1990 when a huge amount of growth and momentum lay ahead. Ah, who knew? The problem, again, is -- at what point has the market discounted the "hoped-for" amount of growth that "hopefully" lies ahead?

All eyes are now on the Nasdaq with bulls and "buy-the-dippers" looking (as always) for new highs. Last week on April 4 the Nasdaq put in its crash-and-recovery all in the same day. But in the three days that followed, the Nasdaq rallied but on lower volume each successive day. My guess: the Nasdaq will probably test its closing low of April 4 in the 4170 area.

In the meantime, to my mind the biggest mystery in this market is the persistent strength in the bonds. The bonds act as if there's either major market trouble ahead, a slowdown in the economy ahead or even a recession ahead. The bond market's advance has been huge in the face of the successive Greenspan warnings of higher rates ahead. Bond buyers tend to be conservative and sophisticated. I've seldom seen the bonds move this powerfully in the face of strong business and all-out bullishness toward common stocks.

NEXT MAILING: May 3, 2000